

Nelson Mandela Bay Metropolitan Municipality

Audit Report

For the year ended 30 June 2016

Report of the auditor-general to the Eastern Cape Provincial Legislature and the council on Nelson Mandela Bay Metropolitan Municipality

Report on the consolidated and separate financial statements

Introduction

1. I have audited the consolidated and separate financial statements of the Nelson Mandela Bay Metropolitan Municipality set out on pages ... to ..., which comprise the consolidated and separate statement of financial position as at 30 June 2016, the consolidated and separate statement of financial performance, statement of changes in net assets , statement of cash flows for the year then ended, as well as the notes, comprising a summary of significant accounting policies and other explanatory information.

Accounting officer's responsibility for the consolidated and separate financial statements

2. The accounting officer is responsible for the preparation and fair presentation of these consolidated and separate financial statements in accordance with South African Standards of Generally Recognised Accounting Practice (SA Standards of GRAP) and the requirements of the Municipal Finance Management Act of South Africa, 2003 (Act no.56 of 2003) (MFMA) and Division of Revenue Act of South Africa, 2014 (Act no.01 of 2015) (DORA), and for such internal control as the accounting officer determines is necessary to enable the preparation of consolidated and separate financial statements that are free from material misstatement, whether due to fraud or error.

Auditor-general's responsibility

3. My responsibility is to express an opinion on these consolidated and separate financial statements based on my audit. I conducted my audit in accordance with International Standards on Auditing. Those standards require that I comply with ethical requirements, and plan and perform the audit to obtain reasonable assurance about whether the consolidated and separate financial statements are free from material misstatement.
4. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated and separate financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the consolidated and separate financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated and separate financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control.

An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated and separate financial statements.

5. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my qualified audit opinion.

Basis for qualified opinion

Irregular expenditure

6. The municipality did not have adequate systems in place to identify and disclose all irregular expenditure incurred during the year as required by section 125(2)(d)(i) of the MFMA. The irregular expenditure disclosed in note 44.2 to the financial statements was understated. Due to lack of systems, and non-availability of sufficient appropriate audit evidence for all awards, it was impracticable to determine the full extent of the understatement of irregular expenditure. Consequently, I was unable to determine whether any further adjustments were necessary to the closing balance of irregular expenditure disclosed at R3,37 billion (2015:R2,1 billion).

Qualified opinion

7. In my opinion, except for the possible effects of the matter described in the basis for qualified opinion paragraph, the consolidated and separate financial statements present fairly, in all material respects, the financial position of the Nelson Mandela Bay Metropolitan Municipality as at 30 June 2016 and its financial performance and cash flows for the year then ended, in accordance with the SA Standards of GRAP and the requirements of the MFMA and DORA.

Emphasis of matters

8. I draw attention to the matters below. My opinion is not modified in respect of these matters.

Restatement of comparative figures

9. As disclosed in note 40 to the consolidated and separate financial statements, the comparative figures for 30 June 2015 have been restated as a result of errors that were only corrected during the financial year ended 30 June 2016 but that existed in the consolidated and separate financial statements of the municipality at, and for the year ended, 30 June 2015.

Fruitless and wasteful expenditure

10. As disclosed in note 44.3 to the consolidated and separate financial statements, fruitless and wasteful expenditure amounting to R49.6 million (2015: R146.3 million) was incurred during the current financial year mainly due to operating costs incurred related to the Integrated Public Transport System (IPTS), garnishees served as well as interest raised on arrear contribution to pension funds.

Material losses and impairments

11. As disclosed in note 15 to the consolidated and separate financial statements, the impairment of receivables amounted to R656 million (2015:R445 million) for the year.
12. As disclosed in note 35.10 to the consolidated and separate financial statements, water losses of 41.4% amounting to R170 million (2015: 42.7% amounting to R148 million) were incurred during the financial year.
13. As disclosed in note 35.11 to the consolidated and separate financial statements, electricity losses of 12.5% amounting to R291 million (2015: 12% amounting to R244.4 million) were incurred during the financial year.
14. As disclosed in note 35.12 to the consolidated and separate financial statements, revenue foregone amounting to R 130 million (2015: R79 million) has been disclosed due to all consumers not being billed for water and electricity.

Significant uncertainty

15. The municipality is a defendant in a number of lawsuits to the amount of R122 million (2015: R82 million) as disclosed in note 45a to the consolidated and separate financial statements. The outcome of these lawsuits cannot be determined at present as litigation is still in progress.

Additional matter

16. I draw attention to the matter below. My opinion is not modified in respect of this matter

Unaudited disclosure notes

17. In terms of section 125(2) (e) of the MFMA the municipality is required to disclose particulars of non-compliance with this legislation. This disclosure requirement did not form part of the audit of the consolidated and separate financial statements and accordingly I do not express an opinion thereon.

Report on other legal and regulatory requirements

18. In accordance with the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA) and the general notice issued in terms thereof, I have a responsibility to report findings on the reported performance information against predetermined objectives of selected development objective presented in the annual performance report, compliance with legislation and internal control. The objective of my tests was to identify reportable findings as described under each subheading but not to gather evidence to express assurance on these matters. Accordingly, I do not express an opinion or conclusion on these matters.

Predetermined objectives

19. I performed procedures to obtain evidence about the usefulness and reliability of the

reported performance information of the following selected development objective presented in the annual performance report of the Nelson Mandela Bay Metropolitan Municipality for the year ended 30 June 2016.

- Development objective: Basic Service Delivery and Infrastructure on page xx to xx
20. I evaluated the usefulness of the reported performance information to determine whether it was presented in accordance with the National Treasury's annual reporting principles and whether the reported performance was consistent with the planned development objective. I further performed tests to determine whether indicators and targets were well defined, verifiable, specific, measurable, time bound and relevant, as required by the National Treasury's *Framework for managing programme performance information* (FMPPI).
21. I assessed the reliability of the reported performance information to determine whether it was valid, accurate and complete.
22. I did not raise any material findings in respect of the reliability of the reported performance information for *KPA 1: basic service delivery and infrastructure development*.
23. The material finding in respect of the usefulness of *KPA 1: basic service delivery and infrastructure development* is as follows:

Basic Service Delivery and Infrastructure

Usefulness of reported performance information

24. Section 54(1)(c) of the MFMA determines that the service delivery and budget implementation plan adopted by the municipal council may be amended only if the council approves an adjustments budget. Changes to the service delivery and budget implementation plan in the year have to be made in accordance with the process as prescribed per section 28 of the MFMA. Material changes were made to important indicators and targets in the annual performance report, without adoption by the municipal council.

Additional matters

25. I draw attention to the following matters:

Achievement of planned targets

26. Refer to the annual performance report on pages x to x; x to x for information on the achievement of the planned targets for the year. This information should be considered in the context of the material findings on the usefulness of the reported performance information in paragraph 25 of this report.

Adjustment of material misstatements

27. I identified material misstatements in the annual performance report submitted for auditing. These material misstatements were on the reported performance information of the Basic Service Delivery and Infrastructure development objective. As management subsequently corrected the misstatements, I did not identify any material findings on the reliability of the reported performance information.

Compliance with legislation

28. I performed procedures to obtain evidence that Nelson Mandela Bay Metropolitan Municipality had complied with applicable legislation regarding financial matters, financial management and other related matters. My material findings on compliance with specific matters in key legislation, as set out in the general notice issued in terms of the PAA, are as follows.

Annual financial statements

29. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122 of the Municipal Finance Management Act.

30. Material misstatements of Property Plant and Equipment as well as the Leave accrual identified by the auditors in the submitted financial statements were subsequently corrected, but the uncorrected material misstatements and supporting records that could not be provided resulted in the financial statements receiving a qualified audit opinion.

Strategic planning and performance management

31. Revisions to the service delivery and budget implementation plan were not approved by the council after the approval of the adjustments budget, as required by section 54(1)(c) of the MFMA.

32. The performance management system and related controls were inadequate as it did not describe and represent the processes of performance monitoring and how it is conducted, organised and managed, as required by sections 38 of the MSA and regulation 7 of the Municipal planning and performance management regulations.

Procurement and contract management

33. I could not obtain sufficient appropriate audit evidence that all contracts were awarded in accordance with the legislative requirements and a procurement process which is fair, equitable, transparent and competitive, as SCM unit is under staffed and No proper record keeping controls in place.
34. Goods and services with a transaction value of below R200 000 were procured without obtaining the required price quotations, in contravention of by SCM regulation 17(a) and (c).
35. Goods and services of a transaction value above R200 000 were procured without inviting competitive bids, as required by SCM regulation 19(a). Deviations were approved by the accounting officer even though it was not impractical to invite competitive bids, in contravention of SCM regulation 36(1).
36. I could not obtain sufficient appropriate audit evidence that invitations for competitive bidding were advertised for a required minimum period of days, as required by SCM regulation 22(1) and 22(2).
37. Bids were not always evaluated by bid evaluation committees which were composed of officials from the departments requiring the goods or services and at least one SCM practitioner of the municipality as required by SCM regulation 28(2).
38. Contracts were awarded to bidders based on preference points that were not allocated and calculated in accordance with the requirements of the Preferential Procurement Policy Framework Act and its regulations.
39. Contracts were awarded to bidders that did not score the highest points in the evaluation process, in contravention of section 2(1)(f) of the Preferential Procurement Policy Framework Act.
40. Construction contracts were awarded to contractors that were not registered with the Construction Industry Development Board (CIDB) did not qualify for the contract, in contravention of section 18(1) of the CIDB Act and CIDB regulations 17 and 25(7A).
41. I could not obtain sufficient appropriate audit evidence that all extensions or modifications to contracts were approved by a properly delegated official, as required by SCM regulation 5.
42. The performance of contractors or providers was not monitored on a monthly basis, as required by section 116(2)(b) of the MFMA.
43. The contract performance and monitoring measures and methods were insufficient to ensure effective contract management, as required by section 116(2)(c) of the MFMA.
44. Awards were made to providers who are in the service of other state institutions, in contravention of MFMA 112(j) and SCM regulations 44. Similar awards were identified in the prior year and no effective steps were taken to prevent or combat the abuse of the SCM process in accordance with SCM regulation 38(1).

45. Awards were made to providers who are in the service of the municipality and/or whose directors are in the service of the municipality in contravention of section 112(j) of the MFMA and SCM regulations 44. Similar non-compliance was reported in the prior year and the municipality did not take disciplinary action against the officials involved.
46. Persons in the service of the municipality who had a private or business interest in contracts awarded by the municipality failed to disclose such interest, as required by SCM regulation 46(2)(e) and the code of conduct for staff members issued in terms of MSA.
47. Contracts were awarded to providers whose tax matters had not been declared by the South African Revenue Service to be in order, as required by SCM regulation 43.

Expenditure management

48. Reasonable steps were not taken to prevent irregular expenditure and fruitless and wasteful expenditure, as required by section 62(1)(d) of the MFMA.

Consequence management

49. Irregular, fruitless and wasteful expenditure incurred by the municipality was not investigated to determine if any person is liable for the expenditure, as required by section 32(2)(b) of the Municipal Finance Management Act.
50. Losses resulting from fruitless and wasteful expenditure were not always recovered from the liable person, as required by section 32(2)(b) of the Municipal Finance Management Act.
51. Allegations of financial misconduct laid against officials of the municipality were not investigated as required by section 171(4)(a) of the Municipal Finance Management Act.
52. Allegations of financial misconduct laid against officials of the municipality were not investigated in accordance with the requirements of Municipal regulations on financial misconduct procedures and criminal proceedings 5(4).

Internal control

53. I considered internal control relevant to my audit of the financial statements, annual performance report and compliance with legislation. The matters reported below are limited to the significant internal control deficiencies that resulted in the basis for qualified opinion, the findings on the annual performance report and the findings on compliance with legislation included in this report.

Leadership

54. Leadership did not set the appropriate tone at the top throughout the year to lead by example and this is evident from the numerous allegations against senior management officials and subsequent suspensions and resignations of top officials.
55. The high vacancy rate in key management has resulted in a weak control environment within the municipality.
56. There was inadequate oversight by leadership over the commitments made to address the internal control weaknesses relating to supply chain management.
57. Management did not exercise adequate oversight over the performance information process as the amended service delivery and implementation plan was not approved by the council as required by the act.
58. Oversight over compliance with laws and regulations was not effective resulting in numerous instances of transgressions of relevant laws and regulations. The lack of adequate consequence management also contributed to the culture of non-compliance.

Financial and performance management

59. The municipality did not consistently implement and monitor the required daily and monthly financial disciplines to ensure that transactions were appropriately recorded and reported, as required by the financial reporting framework. The lack of financial discipline and monitoring during the financial year resulted in key reconciliations and processing only being performed after the financial year-end, and led to numerous material adjustments required to the financial statements during the audit process.
60. Management did not adequately monitor the actions and outputs of officials throughout the year under review to ensure compliance with key legislation. In addition the awareness of SCM requirements amongst officials across all functional areas was not at the required level, as evidenced by the amount of irregular expenditure identified during the audit. There was inadequate documentation and records management to ensure that sufficient, appropriate audit evidence existed in the area of SCM.

Governance

61. The effectiveness of the audit committee and internal audit was impacted by management's poor response to recommendations that were made for improvements, this is evidenced by the material findings on the annual financial statements, performance report and non-compliance with applicable laws and regulations.

Investigations

62. National Treasury conducted a forensic investigation on the Integrated Public Transport System project. A preliminary report was tabled, which implicated officials. A draft report was tabled in Council on 27 August 2015, which recommended that criminal charges be instituted against officials and entities. Council adopted the recommendations. The investigation by National Treasury is still on-going.

63. Council appointed a firm of investigators to investigate allegations of misconduct against officials. The report was tabled in Council on 27 August 2015 and Council recommended further investigations and disciplinary action. The matter is in progress

Auditor-General

Auditor-General

East London

14 December 2016



Auditing to build public confidence